No. 22537

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

HALDEMAN PIPE & SUPPLY COMPANY, a corporation,
Debtor.

On Appeal From the United States District Court of the Central District of California.

APPELLANT'S OPENING BRIEF.

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Statement of Jurisdiction.

This is an appeal by an Attorney for a Receiver in a proceeding under Chapter XI of the Bankruptcy Act. The appeal is from an Order of the Bankruptcy Referee—as affirmed by the District Court—denying all compensation for legal services rendered to the Receiver in the course of the said proceeeding.

The Referee's jurisdiction to set the fee rests on Section 38(6) of the Bankruptcy Act (11 U.S.C. Section 66).

The District Court's jurisdiction to review the Order of the Referee rests on Section 39(c) of the Bankruptcy Act (11 U.S.C. Section 67).

This Court's jurisdiction rests on Section 24(a) of the Bankruptcy Act (11 U.S.C. Section 47).

Statement of the Case.

The within proceeding was filed under the provisions of Chapter XI, Section 322, of the Bankruptcy Act on May 31, 1963.

A. J. Bumb was appointed Receiver on the same date, and Appellant was employed as Attorney for the Receiver by an Order made and entered on June 6, 1963.

Thereafter, Appellant performed extensive legal services on behalf of the Receiver in a variety of matters for a period of approximately three years.

Following the filing of an Application for Compensation by Appellant, an Order was made and entered on June 15, 1967, which denied to Appellant any compensation for the services he had rendered on the ground that he had represented a general creditor whose claim was guaranteed by the principal shareholders of the corporate debtor, and as a result there was the possibility of a conflict of interest when the Receiver later attempted to recover assets from such principals on behalf of the corporate debtor.

Said Order recites that the fair and reasonable value of the services rendered to the Receiver by Appellant is the sum of $12,500.00. However, the Referee in Bankruptcy found that Appellant had failed to comply with the requirements of General Order 44, and as a result, the Court was required to disallow the entire compensation to which Appellant might otherwise be entitled.

On July 3, 1967, being within an extended time fixed by the Court, Appellant filed a Petition for Review of that portion of said Order disallowing all compensation. On August 16, 1967, the Referee filed his Certificate on Petition for Review.

On October 31, 1967, the United States District Court entered its Order Affirming the Order of the

Referee in Bankruptcy, approving and adopting the Referee's Findings of Fact and Conclusions of Law filed in connection therewith, and dismissing the Petition for Review.

On November 14, 1967, Appellant filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit from the District Court's Order.

Statement of the Facts.

On May 28, 1963, Appellant received a telephone call from Chicago from one William Collen (hereinafter referred to as "Collen"). Collen was an attorney in the firm of Collen, Kessler and Kadison, who represented Manufacturers Clearing House and who, as a result, represented approximately ten creditors of Haldeman Pipe & Supply Company, a California corporation (hereinafter referred to as "Haldeman").

Prior to the aforementioned telephone call, and on May 24, 1963, Collen had been present at a meeting of Haldeman's larger creditors, which was held in Los Angeles. Haldeman had been having difficulties in meeting its obligations, and the purpose of the meeting was to work out a settlement arrangement. At that time, one Leonard Goldman, an attorney in Los Angeles, was representing Haldeman.

During the aforementioned phone call, Collen told Appellant the name of the creditors whom he represented, and asked if Appellant would represent them locally as he could not keep running out to Los Angeles in order to keep track of the status of the negotiations.

Appellant agreed with Collen to undertake such representation and, per Collen's request, placed a call to Goldman in order to ascertain the posture of the proposed settlement arrangements. During this phone con-

versation, Goldman mentioned that there were difficulties in working out the proposed settlement arrangement, that he remembered Collen as representing a substantial number of creditors, and now that Appellant represented said creditors, he would keep Appellant posted.

On or about May 30, 1963, Goldman called Appellant and indicated that he intended to file on behalf of Haldeman a Petition under Chapter XI of the Bankruptcy Act. He further stated that it would be in the best interest of all of the creditors if Haldeman continued in operation by means of a Receiver. Goldman indicated that, since Appellant apparently represented major creditors of Haldeman, Appellant would be well advised to accompany him and discuss the matter with the Referee to whom the case would be referred.

On May 31, 1963, Goldman filed the Petition under Chapter XI, and immediately thereafter on the same day, along with Appellant, met with the Hon. Russell B. Seymour, the Referee to whom the matter was referred. During the course of said meeting, Referee Seymour called A. J. Bumb and requested him to act as Receiver for the estate. Mr. Bumb consented and was thereupon immediately appointed. Mr. Bumb asked the name of the attorney representing some of the larger creditors, and when Appellant was mentioned, requested that Appellant prepare an application for his employment as counsel for the Receiver.

The major portion of the meeting was spent discussing, in a general way, the problems involved in the proceeding. As Appellant had not known Collen prior to the telephone conversation on May 28, 1963, and had never represented, prior to that time, any of the creditors referred to him by Collen, Appellant's knowledge of the problems involved was extremely limited.

Subsequently, on May 31, 1963, Appellant prepared an Application for the signature of the Receiver, for an Order authorizing the Receiver to employ Appellant as his counsel, as well as an Affidavit signed and sworn to by Appellant, which Affidavit recites, *inter alia,* the following:

> "That affiant represents certain unsecured creditors whose interest, so far as known to affiant, are identical to those of the Receiver herein; that affiant does not represent any interest which is adverse to the Receiver or to the creditors herein. . . ."

On May 31, 1963, Appellant mailed the Application, including his Affidavit, to the Receiver for his signature. On June 4, 1963, Appellant received a second telephone call from Collen in Chicago, in the course of which Collen informed Appellant that one of the creditors which he had referred held a personal guarantee of its claim by Jack Manildi (hereinafter referred to as "Manildi"), who was the President and principal shareholder of Haldeman. Collen stated that he did not know whether Mrs. Manildi had signed the guarantee in that he did not have it in his possession, but that he would endeavor to obtain it.

During said call, Collen requested Appellant to file an action on the guarantee at the earliest possible moment, and in connection therewith, to promptly levy attachments on certain parcels of real property standing in the name of Manildi, in that he had heard that certain other creditors of Haldeman also held personal guarantees executed by Manildi, and that one such creditor had already attached.

Subsequent to the aforementioned phone conversation, and on the same day, Appellant reported and stated to the Receiver in the presence of Goldman that

one of the creditors he represented held a personal guarantee executed by Manildi.

The following day, on June 5, 1963, Collen sent a letter to Appellant, which included a copy of the guarantee, which in fact was executed by both Mr. and Mrs. Manildi.

As was previously mentioned, on June 6, 1963, an Order was entered authorizing the employment of Appellant as counsel for the Receiver. On or about June 8, 1963, Appellant received Collen's letter, including the copy of the guarantee, and proceeded to draft a Complaint against the Manildis and the necessary documents to effectuate an attachment of real property standing in their names. This Complaint was filed on June 10, 1963, and the levies of attachment were made shortly thereafter.

Prior to Appellant's employment as counsel for the Receiver, and during the meeting held with Referee Seymour on May 31, 1963, Appellant was informed by Goldman that an account receivable existed in favor of Haldeman and against a corporation known as Santa Monica Plumbing & Supply Co. (hereafter referred to as "Santa Monica"), and that Haldeman and Santa Monica were related corporations.

Subsequently, and during the course of the Receiver's administration, rumors arose that other claims against Santa Monica might exist in favor of Haldeman. In order to substantiate or dismiss these assertions, shortly prior to July 26, 1963, the Receiver suggested that Appellant prepare an Aplication for an Order authorizing the employment of an auditor to investigate, among other things, transfers between Santa Monica, Manildi and Haldeman. On July 29, 1963, an Order was entered based on said Application authorizing the Receiver's employment of one Albert Kramer (hereinafter

referred to as "Kramer"), for the purposes set forth .hereinabove.

On August 19, 1963, a conference was held attended by Kramer, the Receiver, Appellant, and Hubert F. Laugharn (hereinafter referred to as "Laugharn"), who was attorney for a Court-appointed Unsecured Creditors' Committee. Kramer orally reported that in his opinion it appeared likely that Haldeman had claims against Santa Monica and, although he had not completed his investigation at that point, his suspicions were aroused as to whether there also might be claims against the Manildis individually. According to Kramer, these suspicions against the Manildis were sufficient to warrant proceeding with further investigation.

Immediately following the aforementioned meeting, Appellant conferred with the Receiver. At that time, neither the Receiver nor Appellant knew whether claims would actually develop against the Manildis. However, due to the fact that Appellant represented a general creditor whose claim was guaranteed by the Manildis, it was agreed that the Receiver should have independent advice as to the nature and validity of those claims.

Thereafter, and on or about August 30, 1963, the Court authorized the Receiver to employ Laugharn as Special Counsel to

> "[p]ursue and conclude the said [Kramer's] investigations and, should the facts so warrant to institute in the name of the Receiver as plaintiff, appropriate proceedings to recover any assets or sums of money which the debtor and/or the Receiver may be entitled to receive from Santa Monica Plumbing Supply Company and Jack Manildi and Vina Gale Manildi." [Clerk's Record, p. 54.]

At or about the time Appellant filed the Complaint on the guarantee on June 10, 1963, several other creditors of Haldeman, whose claims were also guaranteed by the Manildis, were attempting to levy on the same real property. As a result of this "race" to attach, none of the guaranteed creditors was absolutely sure of the priority of its levy. As a result, in the latter part of June, 1963, negotiations were commenced between the guaranteed creditors, including the one represented by Appellant, which ultimately resulted in the creation of a "Guaranteed Creditors Trust" (hereinafter called the "Leland Trust").

The real property which had been attached by some or all of the guaranteed creditors became the corpus of this trust, and the Manildis were relieved from further liability under their guarantees, despite the fact that they owned other substantial assets which were not included in the trust corpus. Furthermore, as Kramer had raised the possibility that the Manildis might be liable to Haldeman, the effectiveness of the Leland Trust was conditioned on Court approval.

On September 23, 1963, Laugharn representing the votes necessary to constitute a majority in number and amount voted in favor of a Plan of Arrangement which had the effect of relinquishing any rights the Receiver may have had in the real property constituting the corpus of the Leland Trust. On September 27, 1963, the Referee made and entered his Order confirming said Plan of Arrangement. Laugharn, as Special Counsel for the Receiver, had previously thereto on September 23, 1963, filed an action against Santa Monica and the Manildis.

This litigation was settled and compromised by the payment by Santa Monica to the Receiver of the sum of $32,000. This sum was paid from Santa Monica's

accounts receivable, which had been collected and impounded in a special trust account, and the balance in said account was released to Santa Monica. No part of the settlement sum was paid by the Manildis individually, nor have they ever been adjudicated bankrupt.

Specification of Errors.

1. The Referee and the District Court erred in holding:

(a) That there was a possibility that appellant knew of the existence of the guarantee, or that he had discussed the matter of a suit against Manildi prior to June 4, 1963. [Finding of Fact 7.] By finding that appellant knew other facts, excepting possibly the ones recited above, as of May 31, 1963, the court erroneously creates the inference that evidence was presented which would in some way support such speculation. There is no such evidence.

(b) That at least some of the real property upon which appellant caused attachments to be levied was subsequently sought to be recovered by the receiver in his Superior Court Action No. 825 741. [Finding of Fact 10.] The real property upon which appellant caused attachments to be levied became part of the corpus of the "Leland Trust". [Finding of Fact 16.] The effectiveness of this trust was recognized and approved by the court's order of September 27, 1963 [Finding of Fact 17], which order also reserved to the receiver the causes of action asserted in Superior Court Action No. 825741. [Finding of Fact 17.] It is logically inconsistent for the court to find that it authorized the receiver to attempt to recover certain real property (upon which appellant caused attach-

ments to be levied), and at the time of granting the receiver such authorization, also approved the setting aside of this same real property in a trust, beyond the receiver's reach. While the receiver may have been authorized by the court to attempt to recover real property standing in the name of the Manildis, such real property could never have been the real property upon which appellant had caused attachments to be levied.

(c) That following the meeting with the accountant (Kramer) on August 19, 1963, appellant *"for the first time,"* (Emphasis the court's) notified the receiver that he had sued the Manildis and attached real property standing in their names on behalf of a general creditors, which had the Manildis' guarantee. [Finding of Fact 13.]

There is no evidence to support the finding that this was the "first time" appellant had informed the receiver of this suit and attachment. Exactly the opposite conclusion is indicated by other findings of fact. Finding of Fact 15 states that appellant ". . . mentioned that he represented a 'guarantee' creditor during the course of one of several hearings in connection with the first meeting of creditors. . . ."

Finding of Fact 11 states that on June 4, 1963, appellant "mentioned following a meeting at the Bank of America, that one of the creditors he represented had a personal guarantee executed by the Manildis."

Furthermore, appellant testified that he had informed the receiver of this suit and attachment on several occasions prior to the meeting on August 19, 1963, and the receiver never testified to the contrary. (In fact, the receiver never tes-

tified at any of the three hearings held before the referee in regard to this matter.)

In conclusion, there is no evidence to support the finding that appellant "for the first time" following the meeting on August 19, 1963, informed the receiver of the suit and levy of attachment referred to in Finding of Fact 13.

2. The Referee and the District Court erred in holding that there was an actual, if not yet known, conflict of interest between a receiver on one hand and a general creditor (Amstan) which holds a guarantee of its debt executed by principals of the corporate debtor. [Finding of Fact 20, Conclusion of Law 1.]

3(a). The Referee and the District Court erred in holding that on or before June 6, 1963, appellant knew that his representation of the receiver then was in substantial conflict with his representation of Amstan. [Finding of Fact 21, Conclusion of Law 2.]

(b) The Referee and the District Court erred in holding that on or before June 6, 1963, appellant "should have known" that his representation of the receiver would be, "or at least might become," in substantial conflict with his representation of Amstan. [Finding of Fact 21, Conclusion of Law 2.]

4. The Referee and the District Court erred in holding that appellant's representation of Amstan, in connection with which he sought to recover from the Manildis, was in substantial conflict with the receiver's possible right to recover from the Manildis. [Conclusion of Law 3.]

5. The Referee and the District Court erred in holding that Amstan's levy of attachment on real property standing in the name of the Manildis reduced, and militated against, the receiver's ability to effect collec-

tion of any claim or cause of action he may have had against the Manildis. [Conclusion of Law 4.]

6. The Referee and the District Court erred in holding that appellant's failure to set out in his affidavit the specific facts relating to appellant's representation of Amstan, and its claim against the Manildis, constitutes a substantial violation of, and noncompliance with the provisions of General Order 44. [Conclusion of Law 5.]

7. The Referee and the District Court erred in holding that appellant's failure to set out in his affidavit the specific facts regarding his represention of Amstan, its claims against the Manildis, and the relationships between the Manildis, Santa Monica Plumbing and Supply Co., and the corporate debtor, requires disallowance of any compensation to which appellant might otherwise be entitled as attorney for the receiver. [Conclusion of Law 5.]

Summary of Argument.

The Referee and the District Court have denied appellant all compensation for acting as attorney for a receiver on the basis of the following reasoning:

1. That appellant was not permitted to represent at the same time a receiver and several general creditors of the corporate debtor, where one of such creditors has its claim guaranteed by the principals of such debtor in that dual representation under such circumstances involves a conflict of interest which is not permitted by the Bankruptcy Act.

2. That General Order 44 required appellant to set forth in his affidavit which accompanied the application for his employment, the specific facts that one of the general creditors he represented (Amstan) held the personal guarantee of its claim by the principals of the corporate debtor, and that appellant intended to sue and

attach certain real property standing solely in the name of such principals. The Referee and the Count conclude that this information is required as a matter of law to be set forth in that appellant was required to anticipate that the principals of the corporate debtor may have been diverting corporate assets to themselves, even though no such facts were then known which would substantiate this conclusion, nor were such facts ever proved.

3. That by failing to set forth such information in his affidavit, appellant took the chance that in the event it later appeared that the receiver had a cause of action against such principals, this fact would indicate that there had existed all along an actual, even though unknown, conflict in appellant's representation of the receiver which conflict would require the court under General Order 44 to deny all fees to which he otherwise might be entitled.

In reply to this position, appellant's argument may be stated as follows:

1. That Section 44(c) of the Bankruptcy Act expressly does not disqualify an attorney from representing at the same time a receiver and several general creditors of the corporate debtor, even though one of such creditors has its claim guaranteed by the principals of such debtor.

2. That General Order 44 requires an application for the employment of counsel to set forth to the best of petitioners' knowledge, such facts as might reasonably give rise to a conflict in representation.

3. That the affidavit filed by appellant in connection with the application for his employment contains all facts known to appellant at that time which might reasonably give rise to a conflict in representation, and therefore complied with General Order 44.

4. That following appellant's undertaking of representation of the receiver, a report by an accountant indicated the possibility that the receiver might have claims against the principals of the corporate debtor. That immediately upon learning of this possiblity appellant withdrew from representing the receiver in regard to his potential claim against such principals, and special counsel was appointed by the court to continue to investigate the relationship between the corporate debtor and its principals, and if such investigation should so warrant, to file suit against such principals. That subsequent thereto special counsel contended that the receiver had a cause of action against the principals and requested the court's permission to file an action against such principals and another corporate defendant on behalf of the receiver. The court granted this request, and, subsequent thereto, a settlement of the litigation was approved by the court which did not involve the payment by such principals of any part of the sum recovered.

In conclusion, appellant argues that the denial of all fees to him by the court is not justified by General Order 44 in that:

1. Appellant did not represent an interest adverse to the receiver;

2. Appellant's Affidavit filed in conjunction with the application for his employment complied with the requirements of General Order 44; and

3. To deny all fees to appellant under the circumstances of this case for his representation of the receiver would constitute an abuse of any discretion the court may be given by General Order 44.

Questions Presented.

1. Does the Bankruptcy Act prevent an attorney from representing at the same time a Receiver and several general creditors of the corporate debtor, one of whom has its claim guaranteed by the principal shareholders of such debtor?

2. Does General Order 44 require that an application for an order authorizing a Receiver to employ an attorney on a general retainer set forth the specific facts that the proposed attorney represents, among general creditors, a general creditor

(a) whose claim is guaranteed by the principals of the corporate debtor, and

(b) that the proposed attorney contemplates suing and attaching property standing in the name of such principals on behalf of such general creditor,

where no facts are then known which would indicate that the Receiver might have a cause of action against such principals?

3. Does General Order 44 grant to the court the discretion to disallow all fees to an attorney

(a) where without actual knowledge of a possible conflict, an attorney represents a Receiver for a corporate debtor and also a general creditor which has its claim guaranteed by the principals of the debtor corporation,

(b) where such attorney levies an attachment on real property on behalf of such general creditor on real property standing solely in the names of the principals of such corporate debtor,

(c) where subsequent to undertaking such dual representation, and levy of attachment, a suspicion is raised that the corporate debtor may have a claim against such principals,

(d) where such attorney immediately withdraws from advising the Receiver with regard to the possibility of establishing such claims and special counsel is promptly appointed to advise the Receiver in this regard,

(e) where the real property upon which such attorney levied the attachment on behalf of the general creditor, becomes part of the corpus of a trust, and

(f) where the court approves, with the acquiescence of such special counsel, the provisions of said trust, thereby permanently preventing the Receiver from recovering for the estate, any of the trust corpus.

4. Is it an abuse of discretion which may be given to the court in General Order 44 to deny all fees to an attorney who represents a Receiver under the circumstances set forth in Question 3 above?

ARGUMENT.

I.

Section 44(c) of the Bankruptcy Act Expressly Does Not Disqualify Appellant From Representing at the Same Time a Receiver and Several General Creditors of the Corporate Debtor, One of Whom Has Its Claim Guaranteed by the Principal Shareholders of Such Debtor.

(1) Subdivision (c) Was Added to Section 44 to Specifically Permit an Attorney to Represent Both the Receiver and a General Creditor Where Only the Possibility of a Conflict of Interest Exists.

Section 44(c) of the Bankruptcy Act reads as follows:

> "§44 *Trustees; Creditor's Committees;* and *Attorneys.* . . .
>
> "(c) An attorney shall not be disqualified to act as attorney for the receiver or trustee by reason of his representation of a general creditor."

Subdivision (c) was added to Section 44 of the Bankruptcy Act in 1938 (June 22, 1938, c. 575 §1, 52 Stat. 860), and in order to understand the reasons for the addition of this subdivision, it is necessary to undertake a brief review of the structure of the Bankruptcy Act itself and the relationship of the Act to the General Orders in Bankruptcy.

Until its repeal in 1964, Section 30 of the Bankruptcy Act authorized the Supreme Court to make all necessary rules, forms and orders *as to procedure* necessary to carry out the provisions of the Act. Generally speaking, the General Orders are not construed to add anything to the Act, but merely to aid in its execution. *West Co. v. Lea Bros. & Co.,* 174 U.S. 590, 19 S. Ct. 836, 43 L. Ed. 1098 (1899).

When it is necessary to construe a General Order, courts take into consideration the purpose to be accomplished by the Act. *Matter of L.M. Axle Co.* (C.C.A. 6 Cir.), 5 A.M.B.R. (N.S.) 734, 3 F. 2d 581 (1925); *Matter of Hodges* (D.C. Conn.), 23 A.M.B.R. (N.S.) 266, 4 F. Supp. 804 (1933), aff'd (C.C.A., 2d Cir.) 25 A.M.B.R. (N.S.) 346, 70 F. 2d 243 (1934), and, similarly, where a General Order is amended, the previous Order should be studied with the amended Order to determine the purpose of the amendment. *Matter of Hodges* (D.C. Conn.), 23 A.M.B.R. (N.S.) 266, 4 F. Supp. 804 (1933), aff'd (C.C.A., 2d Cir.) 25 A.M.B.R. (N.S.) 346, 70 F. 2d 243 (1934).

Section 30 of the Bankruptcy Act was repealed by Public Law 88-623, 78 Stat. 1001 (1964), which became effective on October 3, 1964. In view of the fact that the Act itself describes in great detail the procedures to be followed in bankruptcy cases under Section 30, it was necessary for Congress to act upon many bills which were concerned with no more than procedural changes. In order to relieve Congress of this burden, Public Law 88-623 gave to the Supreme Court of the United States the same general rule—making authority in bankruptcy that it already had in civil procedure, admirality, criminal procedure prior to and including verdict, and review of decisions of the Tax Court. *Collier Bankruptcy Manual,* Matthew Bender & Co. 1965 at pages 395-395.1.

Although Public Law 88-623 repealed Section 30 of the Bankruptcy Act, it *specifically provided* that its repeal did not operate to invalidate or repeal prior orders prescribed under the authority of that section by the Supreme Court. In summary, the purpose of the General Orders in Bankruptcy, which remain in effect despite the 1964 amendment deleting Section 30, is

to aid in the execution of the Act as opposed to amending the Act.

With this background of the relationship of the Bankruptcy Act to the General Orders in Bankruptcy, the reasons which prompted Congress to add Subdivision (c) to Section 44 are more easily understood.

Prior to 1938, some District Courts [New York and elsewhere, although not the Ninth Circuit; see *In re Rury* (C.C.A. 9th (1924), 5 A.B.R. (N.S.) 295, 2 F. 2d 330)] had held that no attorney representing a creditor could also act as an attorney for the receiver or trustee. Analysis of H.R. 1289, 74th Cong. 2d Sess. (1936), at page 157.

The reason for this rule is stated by the court *In Matter of Carlisle Packing Co.* (D.C. Wash.), 12 F. Supp. 8 (1935), and is typical of one branch of judicial thought on this subject at that time. In *Carlisle,* the court held that a creditor's attorney was incompetent to act at the same time as counsel for the trustee. This determination was based upon former General Order 44 (as amended in 1933), and the relation of this General Order to General Order 21(6). General Order 44 stated that an attorney for the trustee could not at the same time represent any interest adverse "to any creditors." As there was the possibility under General Order 21(6) that the trustee would be required to re-examine a creditor's claim, the court felt that an adverse interest would exist in undertaking such dual representation, as an attorney could not represent a trustee who might have the obligation to re-examine the claim of a creditor who was represented by the trustee's attorney.

In summary, New York and several other courts felt that an attorney could not represent a general

creditor and also the receiver or trustee because the General Orders imposed certain duties on these court-appointed officers, the performance of which could give rise to a conflict of interest.

In 1938, Subdivision (c) was added to Section 44 of the Bankruptcy Act, with the stated purpose of abrogating the "New York" rule. The reason for this addition, notwithstanding the continued possibility that a conflict of interest might arise, was explained in the House Report which accompanied the enactment of this particular provision as follows:

> "A rule exists in some district courts (New York and elsewhere) that no attorney for a creditor shall act as attorney for the receiver or trustee. Such rules are fundamentally unsound. There is no reason why an attorney for a general creditor cannot act as attorney for the receiver or trustee because the creditor can act as receiver or trustee (*In re Mayflower Hat Co.,* 23 A.B.R. (N.S.) 366, 65 F.2d 330) and if this can be done then his attorney should be allowed to represent him. A general creditor does not hold any adverse interest which would disqualify his attorney (*In re Rury* (C.C.A. 9th (1924), 5 A.B.R. (N.S.) 295, 2 F. 2d 330).
>
> "If creditors are to be allowed to select the trustee, then such trustee should be free to choose as his attorney, any attorney of the creditors. The only qualification in each case should be that the person selected is not connected with an adverse interest. The fact that the attorney selected is the attorney for a creditor of the estate does not necessarily mean that he is connected with an adverse interest. Creditors have an adverse interest only when they seek to have allotted to them more than a

> pro rata share of the estate, or to retain some advantage over the other creditors which they secured prior to bankruptcy. . . .
>
> "The disqualification should come as it now does against those creditors or their attorneys of any classification who represent one of the special classes of creditors, to wit, secured, preferred, or prior (which claim some priority in distribution), or who represent an adverse interest." (Analysis of H.R. 1289, 74th Cong., 2nd Sess. (1936), at Pages 157-8.)

Following the addition of Subdivision (c) to Section 44, the phrase "any creditor" (the phrase relied upon by the court in *Carlisle*) was deleted from General Order 44.

In conclusion, Congress determined that despite the possibility that a conflict in representation might exist, as it does in any situation where dual representation is permitted, the possibility of such a conflict was more than outweighed by the economies which would result by permitting an attorney to represent a receiver or trustee and also one or more general creditors. In considering this policy determination, the court in *Cal-Neva Lodge, Inc.,* C.C.H. Reports, Para. 62,347 (1967), [Entire Case Attached as Appendix A], recently stated:

> "The policy considerations which led Congress (11 U.S.C. 73(c)) to permit the attorney for a general creditor to represent a receiver or trustee (or debtor in possession) are not subject to review by this court. Like an entrapment which may be lawful or unlawful, this is a conflict of interest which is lawful rather than unlawful." (*Id.* at pp. 5-6.)

(2) **The Fact That One of the General Creditors Represented by Appellant Held a Personal Guarantee of Its Claim Executed by the Principal Shareholders of the Corporate Debtor, Does Not Disqualify Appellant From Representing the Receiver.**

Initially it should be pointed out that the fact that a creditor of a bankrupt also holds a guarantee from a third party, does not alter its status as an unsecured creditor under the Bankruptcy Act. As the court stated in *Doehler Die Casting Co. v. Holmes,* 52 N.Y.S. 2d 321 (1944), at pages 322-323:

> "Only one other defense is worthy of mention. It is claimed that plaintiff, by filing a proof of unsecured debt in the bankruptcy proceedings, waived any claim he might have had against the defendant. However, *a guarantee of a debt of a bankrupt does not make the debt a secured one within the meaning of Section 1(28) of the Bankruptcy Act,* 11 U.S.C.A. §1(28). The security in such a case must be 'upon the property of the bankruptcy.'" (Emphasis added.)

The last sentence of the above quotation raises a significant problem. Had the evidence shown that appellant actually knew at the time he prepared his affidavit, or even at the time that the order authorizing his employment was approved by the court, that the receiver had a cause of action to recover on behalf of the corporate debtor, assets which were in the possession of the guarantors, that fact would disqualify appellant from acting as attorney for both the receiver and such guaranteed creditor. The Findings of Fact made by the court do not, however, find that appellant

had such knowledge. Specifically, Finding of Fact 21 states as follows:

> "That on or before June 6, 1963, the date of entry of the order authorizing his employment as attorney for the receiver, Grodberg actually knew, *or should have known,* that his representation of the receiver was then, or would be, *or at least might become,* in substantial conflict with his representation of Amstan." (Emphasis added.)

This same kind of finding is made by the court in Finding of Fact 20, where the court states:

> "That on May 31, at which time Grodberg prepared his affidavit and the application and order authorizing his employment as attorney for the receiver herein, there was, *in fact, an actual, if not yet known,* conflict of interest as between the receiver on one hand, and Amstan, on the other hand." (Emphasis added.)

There is no finding of fact that appellant actually knew, either at the time the application, affidavit and order was prepared on May 31, 1963, or at the time the order authorizing his employment was entered on June 6, 1963, that the receiver might have some claim against the Manildis. In essence, the court finds that the mere existence of a guarantee of a general creditor's claim by the principal shareholders of the corporate debtor indicates the possibility of a conflict, since there is always the possibility that principals may have been diverting the assets of a corporate debtor, and the possibility of such a conflict disqualifies an attorney from undertaking dual representation.

However, it is clear that the possibility of a conflict of interest, as found by the court in *Carlisle,* does not, as the result of the addition of Subdivision (c) to Section 44 of the Bankruptcy Act in 1938, and the sub-

sequent amendment of General Order 44, prevent an attorney from undertaking such dual representation. As the result of this amendment, and the deletion of the term "any creditor" from General Order 44, the *possibility* that principals of a corporate debtor may have been diverting assets of the debtor to themselves, is, in itself, insufficient to prevent an attorney from undertaking such dual representation.

This conclusion is supported both by the analysis of Congressional intent set forth above, and by the most recent judicial interpretation of Section 44(c) contained *In the Matter of Cal-Neva Lodge, Inc.* In this case the United States had obtained a judgment for delinquent taxes against Sanford D. Adler (Adler), a creditor who had subordinated his claims against the debtor corporation of which he was the principal stockholder. Following the payment of all claims of creditors, a fund remained subject to the control of the court which was available for defraying the expenses of administration, with the balance of said fund to be paid to Adler. The claimants to the funds remaining were the attorneys for the estate and, derivatively, the United States by virtue of Adler's interest in the residue.

The court stated the question before it as follows:

> "The only substantial question of law presented by the Petition for review is that Aaron Levinson, now deceased, one of the court-appointed attorneys for the debtor in possession, should be allowed no compensation for his services because of the failure of the initial petition for appointment of attorneys to disclose adverse interests, in violation of General Order 44. The petition of debtor corporation for the employment of counsel alleges, in part:
>
> > 'That your petitioner proposes, upon the granting of this petition to [retain] LESLIE E. RIGGINS, of Reno, Nevada, the firm of QUITT-

NER AND STUTMAN, of Los Angeles, California, and AARON LEVINSON of Beverly Hills California, as counsel, who have agreed to accept such amount as may be fixed by this Court as compensation for any services rendered to your petitioner, which attorneys and firm of attorneys is now the attorney for the Debtor and whose interest is not adverse to that of the Debtor in possession or to the administration of this estate.'

"The objectors complain that Levinson was then the personal attorney of Sanford D. Adler, the principal stockholder and a large creditor of debtor corporation, and the personal attorney of several other creditors of debtor corporation whose claims aggregating in excess of $650,000 were subsequently filed in the proceeding by Levinson.

"*We conceive no adverse interest between a principal stockholder of a corporation and a corporate debtor in possession in a Chapter XI proceeding.* With respect to corporate creditors, on the face of things their rights are adverse to the debtor in possession, *and if it were not for a specific provision of the Bankruptcy Act, this Court would seriously consider disallowing Levinson's fee because the petition failed to disclose Levinson's connection with the creditors he represented.* Proper practice requires such disclosure in any event under General Order 44. But Congress has seen fit expressly to declare than an attorney shall not be disqualified to act as attorney for a receiver or trustee merely by reason of his representation of a general creditor [11 U.S.C. 72(c)], and a debtor in possession is in substantially the same position as a trustee [11 U.S.C 742]." (*Id.* at pages 4-5). (Emphasis added).

In summary, the possibility of a conflict of interest did not prevent Levinson from undertaking such dual representation because of a specific provision of the Bankruptcy Act, and the order allowing his fees was affirmed by the court.

(3) Neither In re Woodruff, 121 F. 2d 152 (1941), nor Woods v. City National Bank & Trust Co. of Chicago, 312 U.S. 262 (1940), Supports the Proposition That the "Mere Possibility" of a Conflict of Interest Prevents an Attorney From Representing Both the Receiver and a General Creditor.

The Referee and the District Court take the position in Findings of Fact 20 and 21, and in Conclusions of Law 1 and 2, that the *possibility of a conflict of interest, i.e.,* the possibility that the Manildis (principals of the corporate debtor and guarantors of the claims of general creditors) were fraudulently diverting to themselves the assets of the corporate debtor, *per se,* prevents an attorney from representing the receiver and a general creditor with the Manildis' guarantee.

In support of this position the court relies on *In re Woodruff,* C.C.A. 9th (1941), 121 F. 2d 152, and *Woods v. City National Bank & Trust Co. of Chicago,* 312 U.S. 262 (1940), neither of which stand for the proposition for which they are asserted.

In *Woodruff* the receiver's attorneys, Turnbull & Meyberg, were appointed upon a verified petition of the receiver, which, though not signed by Turnbull and Meyberg, was prepared by them. At the time of such appointment and at all times pertinent to the action, Turnbull & Meyberg were also attorneys for a substantial general creditor whose claim was, at that time, disputed by the trustee, and this fact was known to them. In conjunction with the verified petition of the receiver for their employment, Turnbull & Meyberg filed affi-

davits with the court, each stating that he was "not employed by or connected with the bankrupt or any other person having any interest adverse to the receiver, trustee, or creditor." The fact that Turnbull & Meyberg were attorneys for a substantial general creditor whose claim was then in dispute was not disclosed.

The court found that the receiver's petition, and the affidavits filed in connection therewith, did not comply with the requirements of General Order 44. However, the majority of the court did not find that Turnbull & Meyberg had represented an interest adverse to the receiver in any matter upon which they were employed for such receiver, which is the finding required by General Order 44. Instead, the majority of the court determined that Turnbull & Meyberg were not entitled to compensation in that the application for their employment did not disclose the necessity for employing counsel, and an examination of the record indicated to the court that there was in fact no such necessity. As the court stated at page 155:

> "The receiver's petition—written, filed and presented to the court by Turnbull & Meyberg—did not in terms state that it was necessary for the receiver to employ attorneys. It did, however, state that the receiver 'must have legal advice concerning his conduct.' This and other statements in the petition obviously were designed and intended to make it appear that it was necessary for the receiver to employ attorneys. The record discloses no such necessity."

Dissenting in part, Justice Healy stated:

> "Where the trial court has authorized its receiver to employ counsel, I think an appellate court would rarely be justified in rejecting entirely the allow-

ance of compensation because of its belief, after the fact, that an attorney was not necessary. I do not believe that there is justification for that course here."

In conclusion, *Woodruff* does not stand for the proposition that the possibility of a conflict of interest, or, in the words of the court, "an actual, if not yet known, conflict of interest" disqualifies an attorney from representing at the same time both a receiver and several general creditors, one of whom has its claim guaranteed by the principals of a corporate debtor. *Woodruff* does stand for the proposition that where there is no actual necessity for the receiver to employ counsel, an appellate court may make such determination and deny counsel any compensation which may have been allowed in error. To whatever extent the holding in *Woodruff* may be applicable to the case at bar, it should be pointed out that by holding that the reasonable value of the services performed by appellant was the sum of $12,500.00 [Finding of Fact 19], the court also finds by implication that the receiver actually required the services of counsel.

In *Woods v. City National Bank,* the Supreme Court considered the question of whether attorneys who represented an indenture trustee and also bondholders, could be compensated from the estate. The property involved was an apartment hotel. A committee was formed to represent the first mortgage bonds in the reorganization. Counsel to the bondholders' committee had also acted as general counsel for one of the two principal underwriters during the financing of the prop-

erty involved, and that underwriter's prospectus was under attack as containing certain misrepresentations.

The court pointed out that the bondholders' committee which counsel represented was "in substance a part of the indenture trustee's reorganization division." That committee was composed of five members, two of whom were officers or employees of one of the principal underwriters of the bonds, which underwriter was, in addition, heavily interested in the equity. Two members were officers of the indenture trustee. Two members were also members of bondholders' committees for neighboring apartment properties and dominated the committees representing the bonds of those other companies. There was more, but it is plain the evidence of the relationship between the trustee and the committee made up of members with sharply divided loyalties was ample to support the finding of fact of the District Court, which the Supreme Court expressly referred to, that counsel for the trustee and the committee represented conflicting interests.

In conclusion, it was an actual conflict of interest which resulted in the denial of compensation in *Woods,* not the possibility of one which might arise as the result of the dual representation undertaken.

In re Philadelphia & W. Ry. Co., 73 F. Supp., 169 (1947), the scope of the Supreme Court's decision in *Woods* was considered in detail as follows:

> "The more difficult question is whether the fact that the firm represented both the indenture trustee and a group of bondholders makes it necessary to disallow the claim, and the answer depends entirely upon the scope of the decision of the Supreme Court in *Woods v. City National Bank,* 312 U.S. 262, 61 S. Ct. 493, 496, 85 L.Ed. 820.

The Commission argues that that decision lays down the rule that an attorney who represents an indenture trustee at the same time that he is representing bondholders may not under any circumstances be allowed compensation from the estate. I do not think that it goes so far as that.

"There are certain situations in which conflict of interest is always present, of necessity, arising from the nature of the interests themselves. Debtor and creditor, stockholder and bondholder or underwriter are illustrations of these. In such relationships actual conflict is conclusively presumed and the mere fact that counsel represents both sides is enough to forfeit his right to compensation.

"In other cases, while conflict may arise, there is no conclusive presumption that the interests are hostile and whether or not a lawyer represents more than one party must be denied compensation depends upon the existence, as a matter of fact, of a conflict in each particular case. *The mere possibility is not sufficient. As a matter of fact the possibility of conflict exists in almost every case of multiple representation.* Thus, where an attorney represents a large number of individual bondholders there is always a possibility that a minority will find that their interests lie in one direction and the majority in another. When this situation arises the attorney may not continue to represent all but until it does it has never been suggested that his representation of the group is improper. Plainly, representing an indenture trustee and a group of bondholders is in this latter class. An indenture trustee, of course, must act for what it conceives to be the benefit

> of all the bondholders. There may be no division of opinion among them. So long as that is so, there is no actual conflict between its duties toward those whom it represents and its duties toward the bondholders as a whole. If diversity of aims arises between groups of bondholders, there is, of course, no question that the dual representation becomes improper." (*Id.* at p. 172.) (Emphasis added.)

In conclusion, neither *Woods* nor *Woodruff* stands for the proposition for which they are asserted. *Woods,* as interpreted by the court in *In re Philadelphia & W. Ry. Co.,* simply states that in certain situations a conflict of interest is always present, of necessity, because of the nature of the interests themselves. In the case at bar, the nature of the interests themselves do not automatically result in a conflict of interest unless the court presumes a fraud, *i.e.,* that the Manildis were diverting assets of the corporate debtor to themselves without the payment of adequate consideration. Without such a presumption, the nature of the interests themselves do not, by necessity, give rise to any conflict.

The purpose of the addition by Congress in 1938 of Subdivision (c) to Section 44 of the Bankruptcy Act was to eliminate as a bar to dual representation, "presumed frauds" and "possibilities of conflicts of interest." The holding in the case at bar by the referee and the District Court ignores this legislative determination, and attempts to reinstate by the use of the language "actual, if not yet known, conflicts of interest" that branch of judicial thought which was evidenced by the court's decision in *Carlisle.* Neither *Woodruff,* nor *Woods,* sanctions such a "rebirth", and Congress has expressly forbidden it.

II.

The Affidavit Filed by Appellant in Conjunction With the Application for His Employment as Counsel for the Receiver Contained All Facts Then Known to Appellant Which Might Reasonably Give Rise to a Conflict of Interest and Therefore Complied With the Requirements of General Order 44.

At the time appellant prepared his affidavit which was filed in conjunction with the application for his employment as attorney for the receiver, General Order 44, read in pertinent part, as follows:

> "No attorney for a receiver, trustee, or debtor in possession, shall be appointed except upon the order of the court, which shall be granted only upon the verified petition of the receiver, trustee, or debtor in possession, stating the name of the counsel whom he wishes to employ, the reason for his selection, the professional services he is to render, the necessity for employing counsel at all, and *to the best of petitioner's knowledge* all of the attorney's connection with the bankrupt or the debtor, the creditors or any other party in interest, and their respective attorneys . . ." (Emphasis added.)

While there was no specific requirement, at the time the receiver filed his application for the employment of appellant as his attorney, that appellant file an affidavit in conjunction with the receiver's application, the practice is apparently followed by most attorneys, even though the same is a holdover from prior rules existing in this area.

The application, order, and affidavit were prepared by appellant on May 31, 1963, and sent on said date to the receiver for his signature and filing with the

court. The affidavit which was prepared and signed by appellant recites, among other things, the following:

> ". . .; that affiant represents certain unsecured creditors whose interests, *so far as known to affiant,* are identical to those of the receiver herein; that affiant does not represent any interest which is adverse to the receiver or to the creditors herein. . . ." [Finding of Fact 6.] (Emphasis added.)

The order of employment, which was approved by the court on June 6, 1963, recites that appellant was employed for the following reasons or purposes, among others:

> "E. To examine witnesses under the provisions of Section 21-A (sic) of the Bankruptcy Act as the same may be found necessary or appropriate to ascertain facts and to determine if legal action should be taken to preserve assets of this estate including by way of specification and not by way of limitation the relationships between the above-entitled debtor and subsidiary or connected corporations with specific reference to business transactions between them.
>
> "F. To advise and assist applicant in the collection of accounts receivable and all other money, funds and property due and owing to the debtor as the same may be found necessary.
>
> "G. To prepare on behalf of applicant necessary legal applications, answers, orders, reports and other papers.
>
> "H. To confer with the receiver rendering legal advice, and in general to render such other legal services as are usually rendered by attorneys for receivers in like proceedings."

Subsequent to appellant's mailing to the receiver the Application for Employment of Counsel, Affidavit and Order, appellant received on June 4, 1963, a telephone call from the attorney in Chicago who had referred this matter to appellant. Said attorney advised appellant that one of the general creditors (Amstan), who was represented by appellant, held the personal guarantee of its claim by Mr. and perhaps Mrs. Manildi, who were principals of the corporate debtor, Haldeman Pipe & Supply Co. [Finding of Fact 8.] Said attorney requested that appellant file an action on said guarantee at the earliest possible moment, and attach certain real property owned by the Manildis in that he had been informed that other creditors of the corporate debtor also had guarantees, and were proceeding to levy and attach. [Finding of Fact 8.]

Following said telephone conversation, appellant notified the receiver, following a meeting at the Bank of America, that he had been informed that one of the creditors he represented held a personal guarantee executed by one or perhaps both of the Manildis. [Finding of Fact 11.]

Shortly thereafter, and on June 6, 1963, the receiver filed said Application, the Affidavit, and Order, and the same was approved by the court on the same date.

The question remains, whether under the circumstances set forth above, appellant was required by General Order 44 to set forth either in the application for his employment, or in his affidavit, the fact that one of the general creditors he represented held a personal guarantee of its claim executed by one or more of the principals of the debtor corporation. The language of General Order 44 relative to this question reads in pertinent part as follows:

> ". . ., and *to the best of petitioner's knowledge* all of the attorney's connection with the bankrupt

> or the debtor, the creditors or any other party in interest, and their respective attorneys . . .". (Emphasis added.)

The words italicized in the above quotation constitute an express limitation on the information which must be disclosed. Whether the petition actually be prepared by the receiver, or by the attorney acting as agent for the receiver, General Order 44 only requires that the attorney's connections with the bankrupt, debtor, creditors, or any other party in interest, be set forth to the best of either of their knowledge.

Similarly, because of the all-encompassing aspect of the disclosure requirement, it appears reasonable to assume that there is also an implied limitation on the information which must be disclosed. Simply stated, this limitation is to the effect that facts having no apparent relevancy to the matter in question are not required by General Order 44 to be set forth either in the application for employment of counsel or in, as in this case, an affidavit filed in conjunction with such application.

Admittedly, the question of what facts are "relevant" is one about which reasonable men can differ. This is especially true where the court has the ability to take advantage of "20-20 hindsight" in reaching its determination. However, it is clear from the evidence presented, that under the circumstances of this case, appellant could not, at the time he prepared the application for employment of counsel and his affidavit, be reasonably expected to anticipate that the receiver would assert a cause of action against the Manildis at some future date. After the appellant had prepared and sent these documents to the receiver for his execution of the application, appellant, *for the first time,* became aware that one of the creditors he represented

held a personal guarantee of its claim executed by the Manildis. It is submitted that appellant's knowledge of such guarantee should not have immediately suggested to him the necessity of amending his affidavit.

Appellant's initial contact with this case prior to June 4, 1963, came in a phone call on May 28, 1963, when he was first informed by the Chicago attorney that he would like appellant to represent certain of his clients. This telephone conversation was followed by one to counsel for the debtor, and a subsequent meeting with the referee to whom the matter had been assigned on May 31, 1963. The corporate debtor had been in existence for a considerable period of time and had substantial lines of credit with many major suppliers throughout the United States. An example of this fact is Amstan, which had an account receivable in excess of $100,000.00.

On June 4, 1963, when appellant first became aware of the existence of the guarantee, he informed the receiver of that fact and there is no indication that the receiver felt any amendment to appellant's affidavit was necessary at that time. It is submitted that these facts should not have indicated to appellant the necessity of including the existence of the guarantee in either the application for his employment, or appellant's affidavit. Appellant did set forth the fact that he represented certain unsecured creditors whose interests, so far as known to appellant, were identical to those of the receiver.

Under the circumstances of this case, appellant included within his affidavit all facts then known to him which might reasonably give rise to a conflict in representation, and in doing so, complied with the requirement of General Order 44.

III.

Appellant's Representation of Amstan Did Not in Fact Conflict With His Representation of the Receiver, and Therefore the Court Does Not Have the Discretion Under General Order 44 to Deny Appellant the Reasonable Value of His Services.

(1) Itemlab, Inc., 257 F. Supp. 765 (1966), and Cal-Neva Lodge, Inc. Both Require That There Be an Actual Conflict of Interest, Not the Possibility of One, Before the Court Has the Discretion to Deny Fees Under General Order 44.

In Parts I and II of Appellant's Argument it has been shown that the "mere possibility" of a conflict of interest which might arise when an attorney represents both the receiver and a general creditor with a guarantee of his claim by a third party, does not prevent an attorney from undertaking such dual representation. Furthermore, it is submitted that appellant's affidavit filed in conjunction with the application for an order authorizing appellant's employment as attorney for the receiver contained all facts which appellant could reasonably be required to disclose, and therefore complied with the applicable requirements of General Order 44.

The third sentence of General Order 44 sets forth the circumstances in which a court may deny compensation to an attorney who has represented a receiver, and reads as follows:

> "If without disclosure any attorney acting for a receiver or trustee or debtor in possession *shall have represented* any interest adverse to the receiver, trustee, creditors or stockholders *in any matter upon which he is employed for such receiver,* trustee, or debtor in possession, the court

> may deny the allowance of any fee to such attorney, or the reimbursement of his expenses, or both, and may also deny any allowance to the receiver or trustee if it shall appear that he failed to take diligent inquiry into the connections of said attorney." (Emphasis added.)

In summary, General Order 44 requires that before the court acquires the discretion to deny appellant the reasonable value of his services, it must first find that:

(a) Appellant did not make the disclosure required by General Order 44, and

(b) Appellant represented an interest adverse to the receiver in a matter upon which he was employed for such receiver.

Appellant has stated in Part II of this Argument, the reasons why his affidavit complied with the disclosure requirements of General Order 44. It is submitted, therefore, that the requirement of Subparagraph (a) above has not been met.

With regard to Subparagraph (b), judicial interpretation of this provision uniformly requires the court to find, as a fact, that appellant represented an interest adverse to the receiver, *in a matter upon which he was employed for such receiver.*

For example, *In the Matter of Itemlab, Inc.,* 257 F. Supp. 765 (1966), a referee denied compensation to a law firm for services rendered by it as Special Counsel for the Trustee in Bankruptcy. It appears that on July 27, 1961, the debtor, *Itemlab, Inc.* (Itemlab) was adjudicated a bankrupt, and on August 25, 1961, the law firm of McLanahan, Merritt & Ingraham (McLanahan) filed a proof of claim in the amount of $52,600.60 on behalf of Dutch-American Mercantile Corporation (Dutch). Dutch also asserted a lien against

the assets of the estate by virtue of a chattel mortgage given to Dutch's predecessor in interest, Blanmill Realty Corp. (Blanmill).

At a time when the Blanmill chattel mortgage appeared satisfied of record—but actually was not—the bankrupt had executed a second chattel mortgage in favor of Eighteenth Avenue Land Co. (18th Avenue).

Thereafter the Trustee in Bankruptcy petitioned the referee for appointment of McLanahan as special counsel to the trustee for the purpose of representing him in connection with all proceedings designed to set aside the 18th Avenue mortgage. A member of the McLanahan firm filed an affidavit which accompanied said petition, to the effect that said firm "did not represent any interest adverse to the trustee nor had any relationship with the bankrupt except that 'we represent Dutch-American Mercantile Corporation, who is a creditor of the * * * bankrupt'." (*Id.* at p. 765.) The affidavit made no mention of the fact that Dutch asserted a lien against the assets of the estate by virtue of the Blanmill chattel mortgage, and was therefore asserting a position as a secured creditor.

On October 20, 1961, the Referee appointed McLanahan as special counsel, and pursuant to this appointment his firm proceeded to attack the validity of the 18th Avenue mortgage. It was clear that if the 18th Avenue mortgage had been upheld, it would have consumed practically all of the assets of the bankrupt estate.

The 18th Avenue mortgage was successfully set aside, and McLanahan, representing Dutch, instituted a proceeding to direct the Trustee to pay to Dutch the sum of $42,760.00, with interest, as a lien creditor. However, after several proceedings, Dutch's claim as a secured creditor was ultimately denied.

McLanahan, having completed the task of invalidating the 18th Avenue mortgage, applied on January 4, 1965, for compensation and reimbursement for representing the trustee. To this application the trustee responded by a motion for an order disallowing the compensation upon the ground that McLanahan had failed to disclose "an interest adverse to the trustee."

After hearing, the referee granted the trustee's motion. In reversing this determination, the court stated as follows:

> "The result in this case depends to a great extent upon the interpretation and application of the present General Order 44 which is a question of law to which the 'clearly erroneous' standard does not apply. (Citing cases.) It also depends on determination of what constitutes an adverse interest and, if present, whether or not there was disclosure of such interest. General Order 44 relating to the appointment of attorneys for trustees sets forth conditions under which attorneys may be appointed and provides, among other things, that 'If without disclosure any attorney acting for a * * * trustee * * * shall have represented any interest adverse to the trustee * * * *in any matter upon which he is employed for such* * * * *trustee*, the court may deny the allowance of any fee to such attorney'." (Emphasis the court's.) (*Id.* at p. 766.)

In further defining the interpretive formula set forth somewhat generally hereinabove, the court stated that the primary question involved was as follows:

> "The first and foremost question to be decided is whether McLanahan represented an interest adverse to the trustee *when it was employed by the trustee to set aside the 18th Avenue mortgage.*

> An examination of the wording of General Order 44 discloses that it refers to an interest which is adverse in the matter upon which the attorney is employed by the trustee. * * * From the very nature of the proceeding, their interests were necessarily identical. If they were to be successful in recovering any of the assets for the estate, they were compelled to unite in the task of removing this barrier. It is difficult to understand how it can be said that the interests of these two parties were adverse in this particular proceeding which is the only proceeding where General Order 44 is applicable in this case . . . The fact that Dutch claimed a preferred lien and therefore an interest adverse to the trustee in the assets *after* the mortgage was removed did not make its interest adverse to the trustee *before* the mortgage was removed. Community of interest should not be confused with a conflict of interest. Thus it was unnecessary to decide whether McLanahan made sufficient disclosure with respect to Dutch's claim to a preferred status to the Blanmill route after the invalidation of the mortgage." (Emphasis the court's.) (*Id.* at pp. 766-767.)

This kind of factual approach is also found *In the Matter of Cal-Neva Lodge, Inc.*, where the court states at pages 4-5:

> "Although the petition was deficient in failing to disclose 'all of the attorney's connections with the bankrupt or debtor, the creditors or other parties in interest' (General Order 44), a disallowance of fees should follow only 'if without disclosure any attorney acting for * * * the debtor in possession shall have represented any interest adverse to the creditors or stockholders in any matter upon which he is employed for such * * * debtor

in possession.' It is conceded by all that Levinson [one of the attorneys for the debtor in possession] did not in fact represent an interest adverse to the debtor in possession . . .

"If Mr. Levinson did represent Sanford D. Adler, he rendered a service to all other creditors of the debtor in possession by advising him to subordinate his claim to the claims of others. The record we have seen discloses no instance in which Levinson in fact acted adversely to the creditors of the corporation or to the debtor in possession."

In order to determine whether appellant represented an interest adverse to the receiver in any matter upon which he was employed for such receiver, it is necessary to examine the record to ascertain exactly what happened.

(2) Appellant Did Not Without Disclosure Represent an Interest Adverse to the Receiver in a Matter Upon Which He Was Employed for Such Receiver, in That When the Possibility of a Conflict Appeared, Special Counsel Was Appointed.

In the case at bar, shortly prior to July 26, 1963, appellant, acting as attorney for the receiver, prepared an application for the authority to employ an auditor. [Finding of Fact 12.] The reasons for the necessity of employing an auditor are contained in Paragraph 1 of said application, and in pertinent part, read as follows:

"That questions have arisen in the course of administration by the receiver in this proceeding respecting certain transactions between the above-named debtor, on the one hand, and one Santa Monica Plumbing & Supply Co., on the other hand. Additional questions have arisen respecting transactions between certain principals of the debt-

> or, and by way of specification and not by way of limitation, the president thereof, Mr. Jack Manildi, Sr., and involving transfers of real property any other assets reputed to have been made from the debtor to said principals. That it is necessary for the protection of the assets of this estate and to enable the receiver to ascertain whether or not any valuable causes of action exist in favor of this estate as against said named parties and/or other third parties relative to said transactions, that an accounting be taken and that a review from an accounting standpoint be made of the books and records both of the debtor and said other parties." [Clk. Tr. pp. 16-17.]

The aforementioned application was prepared approximately one month and twenty days following the court's order approving appellant's employment as counsel for the receiver, and taking into account the complexities and magnitude of the debtor's business, does not appear to be an excessive amount of time between the commencement of appellant's employment and the preparation of said application.

Thereafter, on July 29, 1963, an order was entered authorizing the receiver to employ an accountant for the purposes described in said application. On August 19, 1963, in the course of a conference attended by the receiver, appellant, the accountant, and Hubert F. Laughran, attorney for the creditors' committee, said accountant orally reported that, in his opinion, it appeared likely that there were claims against Santa Monica Pipe & Supply Co. in favor of the receiver, and, although he had not completed his investigation at that point, his suspicions were aroused as to whether there also might be claims against the Manildis individually. [Finding of Fact 13.]

Immediately following the aforementioned meeting, appellant conferred with the receiver, and suggested that the receiver should employ other counsel to advise him with regard to claims which might develop against the Manildis.

On or about August 28, 1963, proposed special counsel prepared, and on August 30, 1963, the receiver filed, an application for authority to employ special counsel. In Paragraph III of said application the receiver sets forth the reasons for the necessity of employing special counsel which, in pertinent part, read as follows:

> "Santa Monica Plumbing Supply Co. was carried on and operated at all times as a 'division' of the debtor. There were many inter company transactions. The debtor's principal secured creditor is the Bank of America and the said Jack Manildi caused Santa Monica Plumbing Supply to guarantee the said account and likewise caused the debtor corporation to guarantee Santa Monica Plumbing Supply Company's account with the Bank of America.
>
> "That the debtor corporation purchased and acquired merchandise for resale and transferred the some to Santa Monica Plumbing Supply Company at cost. There were certain transactions of a much lesser amount by which Santa Monica Plumbing Supply Company sold to the debtor merchandise which it acquired at cost.
>
> "Investigation is also being conducted with respect to the transactions between the debtor and Santa Monica Plumbing Supply Company with Jack Manildi.
>
> "The investigations upon these matters have not been concluded and the creditors' committee has

demanded there be a reservation in the plan of arrangement giving to the receiver upon behalf of the creditors, all rights of action which may be asserted as the result of said investigation." [Clk. Tr. at p. 53.]

In Paragraph IV of said application, the receiver summarizes the then state of the investigations as follows:

"The receiver alleges it will be in the best interests of the administration herein and the creditors that the receiver be authorized to employ the said firm of Craig, Weller & Laugharn as special counsel to pursue and conclude the said investigation, and, *should the facts so warrant* to institute in the name of the receiver as plaintiff appropriate proceedings to recover any assets or sums of money which the debtor and/or the receiver may be entitled to receive from Santa Monica Plumbing Supply Company and Jack and Vina Gale Manildi." [Clk. Tr. at pp. 53-54.] (Emphasis added.)

It is clear that at the time the receiver filed his application for the employment of special counsel on August 30, 1963, there still was substantial conjecture as to the nature of the claim, if any, which the receiver might have against Santa Monica Plumbing Supply Co. and/or the Manildis. On August 30, 1963, the court authorized the receiver to employ special counsel for the purposes contained in the aforementioned application. Appellant having withdrawn from advising the receiver with respect to these potential claims, took no further part in any of the matters upon which special counsel had been employed to "investigate further."

(3) An Action Filed by Special Counsel Against the Manildis Was Settled With Court Approval Without Establishing That the Manildis Were Liable to the Receiver for Diverting Assets of the Corporate Debtor.

On or about September 20, 1963, special counsel prepared for the signature of the receiver, an application for authority to file an action against Santa Monica Plumbing Supply Co., Jack Manildi and his wife, Vina Gale Manildi. Paragraphs II, III and IV of said application contain the reasons for the necessity of filing said action as determined by special counsel, and read in pertinent part as follows:

II.

"That the debtor has filed herein its Plan of Arrangement which provides in part the following:

'The receiver and the creditors will waive any claim they have for and on behalf of the estate and themselves against Jack and Vina Gale Manildi and Santa Monica Plumbing Supply Company, unless at the time of the hearing re application for confirmation, such actions at law are already on file.'

III.

"The receiver respectfully alleges that he has various causes of action against Jack Manildi and Vina Gale Manildi, officers, directors and owners of the capital stock of the debtor and also against Santa Monica Plumbing Supply Company, a corporation, formerly owned by the debtor and now owned by the said Manildis."

IV.

"Said causes of action pertain to the alleged indebtedness of said Jack Manildi, Vina Gale Manildi and Santa Monica Plumbing Supply Com-

> pany to the debtor and further that the release and transfer by the debtor of the capital stock and ownership of Santa Monica Plumbing Supply Company was a fraudulent transfer and was a scheme, plan and design to deprive the debtor thereof. The receiver has various other causes of action against the three proposed defendants." [Clk. Tr. at pp. 58-59.]

In essence, the application for authority to file the action against Santa Monica and the Manildis states that the "spin-off" of Santa Monica from the debtor was for inadequate consideration, and in effect that the assets of Santa Monica to some extent constitute the assets of the debtor. The application also mentions the fact that the receiver has other causes of action against the Manildis individually, but none are defined. Probably the most important aspect of the application is the fact, as recited in Paragraph II thereof, that under the Plan of Arrangement then on file, unless an action was on file at the time of the hearing *re* application for confirmation of the Plan of Arrangement, such actions would be waived. The hearing in regard to the confirmation of the Plan of Arrangement was set for September 23, 1963, just three days after the aforementioned application for authority to file an action against the Manildis and Santa Monica was filed. [Clk. Tr. at p. 68.] Special Counsel, not wishing to lose any cause of action he might have against the Manildis, requested by his September 20, 1963 application, authority to file suit against the Manildis and Santa Monica, and in fact, subsequent to receiving the court's permission, filed said action on September 23, 1963, the very day scheduled for the hearing in regard to the confirmation of the Plan of Arrangement.

The hearing *re* confirmation was first continued to September 25, 1963, and subsequently to September

27, 1963, at which time the court entered its order confirming the plan. [Clk. Tr. at p. 68.] Said order reserved to the receiver all rights as against the Manildis and Santa Monica Plumbing & Supply Co. previously asserted in the action filed by special counsel on September 23, 1963, and further recognizes the existence of a trust established by those general creditors of the debtor whose claims were guaranteed by the Manildis. [Finding of Fact 17.] In summary, the court reserves to the receiver the causes of action against Santa Monica Plumbing & Supply Co., and the Manildis which were contained in the action filed by special counsel on September 23, 1963, and at the same time, approves the provisions of a trust the corpus of which contains real property standing in the name of the Manildis. The approval of the provisions of this trust automatically placed the corpus beyond the reach of the receiver.

On April 18, 1965, the receiver filed an application prepared by special counsel requesting permission to compromise the action filed against Santa Monica Plumbing Supply Co., and the Manildis on September 23, 1963. According to said application:

> II.
>
> ". . .
>
> "That under the agreements made herein for the collecting and impounding of funds resulting from the collection of accounts receivable of said Santa Monica Plumbing Supply Co., Inc., a trust account was opened in the Bank of America, 660 South Spring Street, Los Angeles, California, in the name of Hubert F. Laugharn and William J. Tiernan, into which the funds from the collections were to be deposited. There is a present balance of $38,035.13 therein."

III.

"The receiver has received an offer from Santa Monica Plumbing Supply Co., Inc., and Jack Manildi and Vina Gale Manildi to compromise the said pending litigation under which compromise the receiver is to receive the sum of $32,000.00. This sum has been delivered to the receiver and he is holding the same in trust until the action of the referee upon his within application. The receiver has agreed to release the balance of the impounded funds, to wit, $6,035.13 in said trust account and $4,414.38 in the account of Santa Monica Plumbing Supply Co., Inc. in United California Bank, Santa Monica Branch, to Santa Monica Plumbing Supply Co., Inc., Jack Manildi and Vina Gale Manildi, and the savings account in the Union Bank in the amount of approximately $20,900.00. The receiver has also agreed to release and assign to Jack Manildi and to Santa Monica Plumbing Supply Co., all accounts receivable of Santa Monica Plumbing Supply Co., heretofore collected or to be collected in the future. They to be accountable for said funds if the receiver's application is not approved." [Clk. Tr. at pp. 88-89.]

On or about April 18, 1965, the court approved the compromise of the aforementioned litigation for the amount set forth in the application, and in essence, permitted the receiver to settle all claims which it may have had against Santa Monica and the Manildis for the sum of $32,000.00, which sum was paid from Santa Monica's accounts receivable. As the application indicates, substantial sums were returned to both Santa Monica and the Manildis. The Manildis have not since been adjudicated bankrupt.

Whether the receiver ever actually had a collectible claim against the Manildis, individually, will never be

known. The litigation filed by special counsel for the receiver on September 23, 1963, named the Manildis as defendants. However, the settlement of that litigation did not involve the Manildis directly paying any of the sum received by the receiver. The important fact to note is, however, that immediately following the accountant's oral report on August 19, 1963, appellant withdrew from advising the receiver with respect to the possibility of establishing a claim against the Manildis. Special counsel was immediately appointed to pursue the investigation which had been started by the accountant, and continued to handle the litigation which was subsequently filed to its conclusion. Appellant in fact did not represent an interest adverse to the receiver on a matter upon which he was employed for such receiver in that when the possibility of a conflict appeared, he immediately withdrew.

(4) Appellant's Representation of the Receiver Until the Time Special Counsel Was Appointed in No Way Conflicted With the Receiver's Possible Rights to Recover Assets From the Manildis.

The referee and the District Court have made findings in the case at bar to the effect that appellant's representation of the receiver during the brief period from June 6, 1963, until the appointment of special counsel on August 30, 1963, in some way may have hindered the receiver in establishing his claim against the Manildis. Each of these findings of fact will be examined separately, and it will be seen that all of them stand for the position previously asserted by the referee and the District Court, that the theoretical possibility of a conflict, even though the same is not shown to exist in fact, is sufficient to deny reasonable compensation to appellant under General Order 44.

Finding of Fact 22 reads as follows:

> "22. That Grodberg's representation of Amstan, in connection with which he sought to recover from the Manildis, was in substantial conflict with the receiver's possible rights to recover from the Manildis."

Initially, the problem with this finding is that any time an attorney represents any person other than the receiver, there is the possibility that such representation may conflict with the receiver's right to recover any sums which may be due from such person. However implicit in Finding of Fact 22 is the conclusion that the receiver did have some right to recover from the Manildis. By innuendo, the court assumes this fact, and then uses it to support the conclusion contained in this finding. As the foregoing analysis has indicated, the possibility of such a right was not substantiated until the accountant gave his oral report on August 19, 1963, and thereupon appellant withdrew and special counsel was appointed. Furthermore, it was never proved that the receiver did in fact have such a claim. The Referee and the District Court both used the word "possible" in defining the nature of the right which the receiver may have had to recover from the Manildis, and in determining whether it amounted to anything more than that, the receiver had the advise of special counsel.

Finding of Fact 23 reads as follows:

> "That Amstan's levy of attachment on real property standing in the name of the Manildis reduced, and militated against, the receiver's ability to effect collection of any claim or cause of action he may have had against the Manildis."

As no facts are presented in support of this conclusion, appellant is confronted with the problem of ar-

guing that Finding 23 is simply not true. In the middle of July, 1963, when the receiver suggested that an accountant be appointed to explore the relationships between the debtor, Santa Monica and the Manildis, appellant immediately prepared the application for the employment of such accountant, which was approved on July 29, 1963. When the accountant reported on August 19, 1963, that there might be claims against the Manildis, appellant withdrew from representing the receiver in this regard and special counsel was appointed.

If in fact Amstan's levy of attachment on the Manildis' real property did in fact "reduce and militate against" the receiver's ability to effect collection of the claim which he asserted against the Manildis, why did the court approve a plan of arrangement which put said real property beyond the reach of the receiver? Furthermore, how can the receiver and the district court find that the receiver's ability to collect the claim which he asserted against the Manildis was "reduced or militated against," when the final settlement of the litigation filed by special counsel resulted in returning funds over which the receiver had control to Santa Monica and the Manildis? It must be presumed that special counsel and the receiver did not return to Santa Monica and the Manildis any property to which the receiver had a valid claim, and, therefore, it is impossible to ascertain the facts upon which the referee and the District Court rely to support Finding of Fact 23.

Finding of Fact 24 reads as follows:

> "That Grodberg's representation of Amstan rendered it improbable that he would advise the receiver that an involuntary petition in bankruptcy against the Manildis should be considered, and, if possible, filed, so as to avoid the various attach-

ments levied by the 'guarantee' creditors, including Amstan, on real property standing in the names of the Manildis."

Again, the referee and the District Court have assumed as the basis of this finding, that appellant, prior to the time he withdrew from representing the receiver with regard to possible claims against the Manildis, should have advised the receiver to consider an involuntary petition in bankruptcy against the Manildis.

Although the referee suggests that perhaps an involuntary petition in bankruptcy against the Manildis should have been considered, the record does not disclose any grounds upon which such a petition could be predicated, nor does the subsequent settlement of the litigation filed by special counsel for the receiver indicate that the same had any chance of success. In essence, the referee and the District Court have simply repeated Finding of Fact 20 which states that dual representation in the case at bar *per se* results in "an actual, if not yet known, conflict of interest." In Finding of Fact 24 the referee and the District Court simply speculate as to possible ways in which this conflict might manifest itself.

Finding of Fact 25 reads as follows:

"That Grodberg's representation of Amstan further rendered it improbable that he would have effectively advised the receiver in relation to any possible course of action which might conflict with or impede, the prior and secured position of Amstan in relation to the Manildi real property, or otherwise."

Again, the referee and the District Court have repeated their basic proposition that an attorney is prevented, *per se,* from representing a receiver and a gen-

eral creditor whose claim is guaranteed by the principals of the corporate debtor.

In reply to these findings, appellant simply states that the record discloses no instance where he actually represented an interest adverse to the receiver in a matter upon which he was employed for such receiver, and theoretical possibilities that he might have done so are insufficient to grant to the court the discretion to deny him under General Order 44, reasonable compensation for his services.

IV.

The Denial of Reasonable Compensation to Appellant for His Representation of the Receiver Constitutes an Abuse of Any Discretion the Court May Be Given by General Order 44.

(1) Woodruff, 121 F. 2d 152 (1941), and Barry Yao Company, 172 F. Supp. 375 (1959), Do Not Support the Referee's and the District Court's Decision That in the Case at Bar, General Order 44 Requires the Denial of All Fees to Appellant.

General Order 44 provides that:

> ". . . .
>
> If without disclosure any attorney acting for a receiver . . . shall have represented any interest adverse to the receiver . . . in any matter upon which he is employed for such receiver . . ., *the court may deny the allowance of any fee to such attorney,* or the reimbursement of his expense, or both, and may also deny any allowance to the receiver . . . if it shall appear that he fails to take diligent inquiry into the connections of said attorney." (Emphasis added.)

The court has held that appellant's failure to set forth in his affidavit the facts of his representation

of Amstan, and the guarantee of its claim by the Manildis, constitutes a substantial violation of and noncompliance with, the provisions of General Order 44, "which *requires* disallowance of any compensation to which he might otherwise be entitled as attorney for the receiver herein." [Conclusion of Law 5.] (Emphasis added.)

The referee in his memorandum *In re* Application for Compensation [Clk. Tr. pp. 139-157] cites in support of this determination, both *In re Woodruff,* 121 F. 2d 152 (1941), and *In re Barry Yao Company,* 172 F. Supp. 375 (1959). In Part I of this Argument, the court's decision in *Woodruff* was considered in detail, and, as will be remembered, the court denied fees to Turnbull & Meyberg by examining the record, and by determining as the result of such examination that no necessity in fact had existed for the employment of counsel. The court in *Woodruff* never found that Turnbull & Meyberg represented an interest adverse to the receiver in a matter upon which they were employed for such receiver.

In re Barry Yao Company, 172 F. Supp. 375 (1959), involved an application for attorneys' fees filed by attorneys who had been appointed special counsel for the receiver. The court stated the question before it as follows:

> "So the specific problem presented is whether attorneys who misrepresent 'the value and extent of the services rendered' as counsel for a receiver, when petitioning for fees pursuant to Section 62, Sub. d of the Bankruptcy Act, are entitled to compensation for such services as they in fact rendered during their employment by the receiver; and if so, whether such misrepresentations affect the amount of the allowance to which the attorneys would otherwise be entitled." (*Id.* at p. 380.)

In answer to this question, the court determined that the attorneys requesting fees had failed to fully and accurately disclose in their petition the material fact as to the "value and extent" of their services as special counsel for the receiver, and by a review of the legislative history of Section 62 (Subdivision d) determined that the court was justified under such circumstances in denying all fees. Relying on an interpretation of the requirements of Subdivision d of Section 62, is of little assistance in the case at bar. The only question before the court is the interpretation and application of General Order 44, the alleged violation of which resulted in the denial of reasonable compensation to appellant.

The court, in exercising its discretion to deny all fees to appellant, undoubtedly is reflecting its basic view of the requirements of General Order 44. According to the referee:

> "It would be my view that an attorney who represents one or more general creditors takes the risk of the penalties imposed by General Order 44 (11 U.S.C.A. following section 53) if, thereafter, adverse position should develop in respect to any of the claims represented by him. To permit exceptions, although equitable reasons might exist, is to place an unnecessary burden on the court." [Clk. Tr. at p. 152; Referee's Memorandum, p. 15, lines 4-10.]

If this court were to sustain the position taken in the foregoing quotation, it would immediately eliminate dual representation, and the benefits which Congress hoped would accrue therefrom. For example, it is always possible that sometime after dual representation is undertaken, the trustee may object to a claim filed by an unsecured creditor who is represented by the

same attorney who represents the trustee. It seems inconceivable that such an objection would disqualify an attorney from being compensated for services performed over a period of years in unrelated matters. But according to the referee, any attorney undertaking dual representation "takes the risk of the penalties" if thereafter adverse positions should develop in respect to any of the claims represented by him. It is submitted that General Order 44 does not require an attorney undertaking dual representation to play "Russian Roulette" with his fees, knowing that should anyone, including the trustee, object to the claim of an unsecured creditor he might represent, this fact would *ipso facto* give the court the discretion to deny to him all attorneys' fees which he had earned. (Such an interpretation is especially untenable when a claim of conflict is made in bad faith and subsequently never proved.)

(2) **Chicago & West Town's Railway v. Friedman, 230 F. 2d 364 (1956), and In re Philadelphia W. Ry. Co., 73 F. Supp. 169 (1947), Are Controlling and Set Forth the General Rule That:**

(i) **Once the Possibility of a Conflict of Interest Arises, an Attorney Should Withdraw as Appellant Did in the Case at Bar, and**

(ii) **An Attorney Should Be Compensated for Beneficial Service Performed Which Are Unrelated to the Matter Giving Rise to the Possibility of a Conflict.**

It is submitted that the proper course of action once the possibility of a conflict becomes apparent, is for the attorney to withdraw as appellant did in the case at bar. Although appellant's research has failed to disclose any decision considering this question with respect to the requirements of General Order 44, both *Chicago & West Town's Railway v. Friedman* (C.A.

7 1956), 230 F. 2d 364, and *In re Philadelphia & W. Ry. Co.,* 73 F. Supp. 169 (1947), consider the questions of "timing a withdrawal" in the context of reorganization proceedings commenced under the Bankruptcy Act, and compensation for beneficial services rendered in matters unrelated to the conflict.

In *Chicago & West Town's Railway v. Friedman* the debtor was a public utility engaged in furnishing transportation in the Chicago area. It had outstanding first mortgage bonds totaling in excess of $2 million, on which on July 1, 1947, there was a default in the matured principal and semi-annual interest.

In September, 1947, two bondholders' committees were permitted to intervene. One was known as the Leason Committee, and was represented by attorneys Raymond B. Morris and Harry A. Biossat. The second one was known as the Friss Committee, which was represented by attorneys William J. Friedman and Maurice Rosenfield, members of the firm of Friedman, Zoline & Rosenfield.

For a period of almost five years negotiations were undertaken to sell the company to the Chicago Transit Authority. When the aforementioned negotiations collapsed in the early part of 1953, Chicago Aurora & Elgin Railway Co. offered to purchase the company. The court eventually approved the plan to sell the company to Aurora & Elgin, and Maurice Rosenfield and William J. Friedman petitioned for fees regarding their employment as attorneys for the Friss bondholders' committee. Among the objections filed were that they were precluded from recovering compensation due to

the fact that they had represented an interest conflicting with that of the debtor. In finding such a conflict, the court stated as follows:

> "Throughout the reorganization, petitioners' (Friedman - Rosenfield) law firm was general counsel for Aurora-Elgin. The appearance for the (Friss) committee was filed by the firm Friedman, Zoline & Rosenfield. Petitioner's partner, Zoline, was a director and also a secretary of that company (Aurora-Elgin)." (*Id.* at p. 368.)

And further at page 369:

> "*When the conflict of interest arose in May, 1963, petitioner could have followed the example of Bell, Boyd, Marshall & Lloyd and have withdrawn as counsel of the Friss committee.* Not having done so they should be penalized any amount for fees that may be made." (Emphasis added.)

Notwithstanding the apparent conflict in representation, and the failure to withdraw, the court went on to permit Friedman and Rosenfield to recover fees for the work they had done *prior* to the time the conflict arose.

In *Chicago & West Town's Railway,* the facts recited by the court tend to indicate that the law firm of Friedman, Zoline & Rosenfield represented Aurora-Elgin, the ultimate purchaser, even before the last-mentioned organization offered to buy the assets of the debtor. As will be remembered, at this time Friedman and Rosenfield were also representing the Friss Committee. It would seem that in this situation there is at least a possibility of a conflict. Rosenfield and Friedman might have advised the bondholders' com-

mittee not to consent to a plan whereby the assets of the debtor would be sold to the Chicago Transit Authority, thereby making such assets available to their client, Aurora-Elgin. Yet, since the court did not find any conflict in fact prior to the time when Aurora-Elgin made its offer to purchase the debtor's assets, the court awarded to Rosenfield and Friedman the reasonable value of their fees for representing the Friss Committee prior to the time the conflict arose.

Similar *In re Philadelphia & W. Ry. Co.,* the Court considered the question of whether the fact that the same firm of attorneys represented both the indenture trustee and a group of bondholders required it to disallow compensation. In concluding that the nature of the interests represented did not require the disallowance of compensation, the court stated as follows:

> "Thus, where an attorney represents a large number of individual bondholders there is always a possibility that a minority will find that their interests lie in one direction and the majority in another. When this situation arises the attorney may not continue to represent all *but until it does it has never been suggested that his representation of the group is improper.*" (*Id.* at p. 172.) (Emphasis added.)

In the case at bar, the possibility that the receiver might have claims against the Manildis did not arise until the accountant made his oral report on August 19, 1963. Immediately thereafter appellant withdrew from advising the receiver with regard to the possibility of establishing such claims. In the receiver's application for the employment of special counsel which was

filed on August 30, 1963, the stated purpose was to investigate further the possibility of establishing such claims.

It is submitted that appellant withdrew from the situation giving rise to the possibility of a conflict as soon as the same became apparent. He thereafter continued to work for the receiver for a period in excess of two years on matters totally unrelated to any claims the receiver might have against the Manildis.

Following the filing of his application for attorney's fees on May 10, 1966, appellant for the first time was informed that the "possibility of a conflict" which appeared some two years before, from which appellant withdrew, with regard to which special counsel was appointed, and which in fact was never proved, required the court under General Order 44 to deny all fees to which he might otherwise be entitled.

In support of this position the referee and the District Court cite numerous possibilities of conflict, but none of them *in fact* existed. If permitted to stand, the court's decision in the case at bar would have the effect of greatly increasing the costs of administration. Each receiver and trustee would have his own permanent personal attorney, none of whom would be directly responsible to the creditors whose interests were actually being administered, and all of whom would share in the bankrupt estate prior to its distribution.

In 1938 when Congress added Subdivision (c) to Section 44 of the Bankruptcy Act, the stated purpose was to reduce the cost of administration by permitting dual representation. This addition and the economies

which it is designed to promote should not fall before the sophistry of "actual, if not yet known, conflicts of interest."

Conclusion.

It is respectfully submitted that the judgment of the District Court be reversed, and that appellant be granted the reasonable value of his services as attorney for the receiver, as found by the referee.

Respectfully submitted,

BEARDSLEY, HUFSTEDLER & KEMBLE,

By STEPHEN R. FARRAND,

Attorneys for Appellant, Haskell H. Grodbreg.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

STEPHEN R. FARRAND

APPENDIX A.

No. 923.

IN THE UNITED STATES DISTRICT COURT, FOR THE DISTRICT OF NEVADA.

In the Matter of

CAL-NEVA LODGE, INC., A NEVADA CORPORATION,
Debtor.

In Proceedings for an Arrangement, Chapter XI.

Order Affirming Fees Allowed by Referee.

This matter is before the Court on the petitions of the United States and of Sanford D. Adler to review the fees ordered paid to the attorneys for the debtor in possession.

The affairs of Cal-Neva Lodge, Inc. have been fully administered in a Chapter XI proceeding which resulted in the liquidation of the properties of the corporation under an approved plan of arrangement. Some eleven years have elapsed since the petition for an arrangement was filed.

A fund remains subject to the control of the Court which is available for the defraying of expenses of administration, the balance to be paid to Sanford D. Adler, a creditor, who subordinated his claims against the debtor corporation, of which he was the principal stockholder, to those of all other corporate creditors. The

approved claims of all other creditors have been paid in full.

The United States, derivatively, asserts the same right as does Adler. The United States has obtained a judgment for delinquent taxes against Adler and has levied upon Adler's claim against the debtor corporation. To the extent the Referee's allowance of attorney fees out of the estate might be reduced, the United States will benefit by pro tanto application of the sum disallowed to satisfaction of its claim against Adler.

Petitions for allowance of fees filed by the attorneys were duly noticed and objections thereto filed by the United States and Adler. Extensive hearings were held, briefs, proposed findings of fact and objections to the proposed findings were filed with the Referee, and the Referee ultimately entered extensive findings of fact and conclusions of law and allowed additional fees of $125,000 to the attorneys for the debtor in possession.

The Court has read the petitions or proofs of claim submitted by the attorneys and the transcript and other evidence submitted. The findings of the Referee are supported by substantial evidence and are adopted and approved by the Court (General Order 47).

Of course, the allowance of compensation to bankruptcy officers and attorneys may always be open to re-examination until the estate is closed. *Goodman v. Street* (9 CCA 1933), 65 F. 2d 686; Collier on Bankruptcy, 14th Ed., Vol. 2, §39.18, p. 1484. The amount of just compensation for attorneys in any particular case is a matter of opinion and discretion. The general guidelines are that an estate should not, on the one hand, be unreasonably mulcted for the benefit of the at-

torneys, and that the attorneys, on the other hand, should not be awarded niggardly compensation for valuable services. The Referee's exercise of discretion in this area is subject to review. *Official Creditors Committe of Fox Markets, Inc. v. Ely* (9 CCA 1964), 337 F. 2d 461.

The Referee who allowed the fees supervised most of the proceedings. The allowances made are certainly not niggardly, but the facts as found by the Referee amply justify the allowance not only on a time basis but with reference to the results achieved and the benefits to the estate. "He was in a far better position than we to appraise how valuable * * * * (the) * * * * services were in reducing asserted claims; that is, to know whether the accomplishment was an easy or difficult one." *Miller v. Robinson, Trustee* (9 CCA, May 3, 1967), ... F. 2d .....

The only substantial question of law presented by the Petition for review is that Aaron Levinson, now deceased, one of the court-appointed attorneys for the debtor in possession, should be allowed no compensation for his services because of the failure of the initial petition for appointment of attorneys to disclose adverse interests, in violation of General Order 44. The petition of debtor corporation for the employment of counsel alleges, in part:

> "That your petitioner proposes, upon the granting of this petition to [retain] LESLIE E. RIGGINS, of Reno, Nevada, the firm of QUITTNER AND STUTMAN, of Los Angeles, California, and AARON LEVINSON of Beverly Hills, California, as counsel, who have agreed to accept such amount as may be fixed by this Court

> as compensation for any services rendered to your petitioner, which attorneys and firm of attorneys is now the attorney for the Debtor and whose interest is not adverse to that of the Debtor in possession or to the administration of this estate."

The objectors complain that Levinson was then the personal attorney of Sanford D. Adler, the principal stockholder and a large creditor of debtor corporation, and the personal attorney of several other creditors of debtor corporation whose claims aggregating in excess of $650,000 were subsequently filed in the proceeding by Levinson.

We conceive no adverse interest between a principal stockholder of a corporation and a corporation debtor in possession in a Chapter XI proceeding. With respect to corporate creditors, on the face of things their rights are adverse to the debtor in possession, and if it were not for a specific provision of the Bankruptcy Act, this Court would seriously consider disallowing Levinson's fee because the petition failed to disclose Levinson's connection with the creditors he represented. Proper practice requires such disclosure in any event under General Order 44. But Congress has seen fit expressly to declare that an attorney shall not be disqualified to act as attorney for a receiver or trustee merely by reason of his representation of a general creditor [11 U.S.C. 72(c)], and a debtor in possession is in substantially the same position as a trustee [11 U.S.C. 742]. In a bankruptcy context, the Referee's Finding No. XIII that "Levinson represented no interest adverse to the creditors or stockholders of Cal-Neva Lodge, Inc." is correct. Although the petition was deficient in failing to disclose "all of the attorney's

connections with the bankrupt or debtor, the creditors or other parties in interest" (General Order 44), a disallowance of fees should follow only "if without disclosure any attorney acting for * * * a debtor in possession shall have represented any interest adverse to the creditors or stockholders in any matter upon which he is employed for such * * * debtor in possession." It is conceded by all that Levinson did not in fact represent an interest adverse to the debtor in possession. In the language of the brief of the United States, "The objector has no proof of bad conduct on the part of Mr. Levinson, but the law does not require such proof." In *In Re Barceloux* (9 CCA 1934), 74 F. 2d 289, the Court said:

> "In the case at bar, no rule of court was violated. The participation of Freeman as an attorney was open, and the services rendered admittedly were valuable and a benefit to the estate, and this is no controversy as to division of fees between attorneys, and, in any action taken in rendering the services for which compensation was allowed, there was no conflict with the interest of the estate.
>
> "In considering the principle here involved, this court in In re Rury (C.C.A. 9) 2 F. 2d 331, page 332, in a decision by Judge Rudkin, said: 'Petitioner also sought to disqualify the attorney who appeared before the state court for the trustee upon the ground that he had also acted as attorney for a creditor of the estate. The latter fact is denied, but the fact itself is not material; nor is it material to inquire whether the question is properly before us. There is no necessary conflict in interest between a creditor and a trustee in bankruptcy, and,

> if the two see fit to join forces and employ the same attorney in an effort to recover assets, the adverse party or a stranger will not be heard to complain.'
>
> "There was a similar holding in In re Levinson, supra."

In *In re Woodruff* (9 CCA 1941), 121 F. 2d 152, an allowance of attorney fees was denied because, among other things, the petition failed to disclose that the attorneys whom the trustee sought to retain represented a large creditor whose claim was disputed by the trustee. This is not the situation here.

If Mr. Levinson did represent Sanford D. Adler, he rendered a service to all other creditors of the debtor in possession by advising him to subordinate his claim to the claims of others. The record we have seen discloses no instance in which Levinson in fact acted adversely to the creditors of the corporation or to the debtor in possession.

The policy considerations which led Congress [11 U.S.C. 73(c)] to permit the attorney for a general creditor to represent a receiver or trustee (or debtor in possession) are not subject to review by this Court. Like an entrapment, which may be lawful or unlawful, this is a conflict of interest which is lawful rather than unlawful. Levinson did not act secretly; rather, for most of the claims he represented, his representation was disclosed on the claim. The failure of the petition for appointment of counsel to disclose his representation of creditors was not his doing, and if disclosure had been made, in all probability it would not have led the Court to reject the appointment requested by the debtor corporation.

In all the circumstances, Aaron Levinson and his personal representatives are not disqualified from receiving compensation for Levinson's services to the debtor in possession.

The Order Re Fees to the Attorneys for Debtor and Debtor in Possession filed by the Referee on May 10, 1966, is hereby affirmed.

Dated: June 16, 1967.

Bruce R. Thompson
United States District Judge

Filed June 16, 1967.